October 28, 2004

Financial Management

Assessment of the U.S. Army Corps of Engineers, Civil Works, FY 2004 Beginning Financial Statement Balance of Construction-In-Progress

(D-2005-008)

Department of Defense
Office of the Inspector General

Constitution of the United States

A Regular Statement of Account of the Receipts and Expenditures of all public Money shall be published from time to time.

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Acronyms

BPA	Bonneville Power Administration
CEFMS	Corps of Engineers Financial Management System
CIP	Construction-in-Progress
COEMIS	Corps of Engineers Management Information System
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office
PP&E	Property, Plant, and Equipment
USACE	U.S. Army Corps of Engineers

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-4704

October 28, 2004

MEMORANDUM FOR COMMANDER AND CHIEF OF ENGINEERS, U.S. ARMY CORPS OF ENGINEERS

SUBJECT: Report on Assessment of the U.S. Army Corps of Engineers, Civil Works, FY 2004 Beginning Financial Statement Balance of Construction-In-Progress (Report No. D-2005-008)

We are providing this report for review and comment. We considered management comments on a draft of this report when preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. The U.S. Army Corps of Engineers comments were responsive but lacked estimated completion dates for all of the corrective actions. We request that the U.S. Army Corps of Engineers provide additional comments for Recommendations A.3 and B.2 by December 28, 2004.

If possible, please send management comments in electronic format (Adobe Acrobat file only) to Aud-Colu@dodig.osd.mil. Copies of the management comments must contain the actual signature of the authorizing official. We cannot accept the / Signed / symbol in place of the actual signature. If you arrange to send classified comments electronically, they must be sent over the SECRET Internet Protocol Router Network (SIPRNET).

We appreciate the courtesies extended to the staff. Questions should be directed to Mr. James L. Kornides at (614) 751-1400, extension 211, or Ms. Amy J. Frontz at (614) 751-1400, extension 213. See Appendix D for the report distribution. The team members are listed inside the back cover.

By direction of the Deputy Inspector General for Auditing:

Paul J. Granetto

Paul J. Granetto, CPA
Assistant Inspector General
for Defense Financial Auditing
Service

Office of the Inspector General of the Department of Defense

Report No. D-2005-008 **October 28, 2004**
(Project No. D2004FJ-0032)

Assessment of the U.S. Army Corps of Engineers, Civil Works, FY 2004 Beginning Financial Statement Balance of Construction-In-Progress

Executive Summary

Who Should Read This Report and Why? U.S Army Corps of Engineers officials and personnel responsible for financial reporting should read this report. It discusses issues related to the financial reporting of Construction-in-Progress on the financial statements.

Background. Construction-in-Progress was part of the $30.9 billion of General Property, Plant, and Equipment assets that the U.S. Army Corps of Engineers reported on its FY 2003 financial statements. We previously reported that the $10 billion beginning Construction-in-Progress balance on the FY 2003 U.S. Army Corps of Engineers Financial Statements was materially overstated.

Results. The U.S. Army Corps of Engineers significantly improved its financial reporting of Construction-in-Progress by removing invalid items and correcting errors. As a result, the U.S. Army Corps of Engineers reduced its Construction-in-Progress balance to $3.8 billion at the end of FY 2003. However, the reduced balance was still not reliable and was misstated by $640 million. In addition, $188 million of valid Construction-in-Progress could not be supported by originating source data. Continued material misstatement and lack of support for Construction-in-Progress will preclude the U.S. Army Corps of Engineers from gaining a favorable audit opinion on its financial statements.

The U.S. Army Corps of Engineers needed to ensure proper implementation of its FY 2004 Construction-in-Progress Information Paper, which addresses deficiencies involving invalid and unsupported Construction-in-Progress assets. The U.S. Army Corps of Engineers also needed to perform a comprehensive review of the Construction-in-Progress account and remove all costs involving the purchase or development of wildlife mitigation land. Additionally, the U.S. Army Corps of Engineers needed to disclose in the financial statements the portion of the Construction-in-Progress balance that will be turned over to other Federal agencies upon completion (finding A).

The U.S. Army Corps of Engineers did not properly account for costs involving the Columbia River Fish Mitigation Program. As a result, the U.S. Army Corps of Engineers overstated its FY 2004 Construction-in-Progress beginning balance by approximately $536 million. In addition, completed Columbia River Fish Mitigation Program work is accruing excessive capital interest charges. The U.S. Army Corps of Engineers needed to address deficiencies involving Columbia River Fish Mitigation Program costs and discontinue accruing capital interest for completed Columbia River Fish Mitigation

Program work (finding B). See the Findings section of the report for the detailed recommendations.

Management Comments and Audit Response. The Commander of the U.S. Army Corps of Engineers concurred with all of the findings and recommendations. The comments were responsive, however, we request implementation dates for all corrective actions and a plan for reporting hydropower-related costs by December 28, 2004. See the finding sections of the report for a discussion of management comments and the Management Comments section of the report for a complete text of the comments.

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Background

We performed this audit assessment to meet the requirements of Public Law 101-576, the "Chief Financial Officers Act of 1990," November 15, 1990, as amended by Public Law 103-356, the "Federal Financial Management Act of 1994," October 13, 1994, and the National Defense Authorization Act of 2002. The U.S. Army Corps of Engineers (USACE), Civil Works, reports General Property, Plant, and Equipment (PP&E) as a line item on the financial statements. For FY 2003, General PP&E was the most significant asset category on the USACE financial statements, reported at a net value of $30.9 billion. USACE uses the Construction-in-Progress (CIP) account to accumulate labor, material, and overhead costs for real property construction projects. Upon completion, the constructed property is either placed in service by USACE as General PP&E or transferred to another Federal or non-Federal agency. CIP represented $3.8 billion (12 percent) of the $30.9 billion PP&E reported on the FY 2003 USACE financial statements. The FY 2003 ending balances represent the beginning balances for the FY 2004 financial statements.

USACE Mission. The USACE Civil Works mission includes: development and management of the nation's water resources; protection, restoration, and management of the environment; disaster response and recovery; and providing engineering and technical services to Federal entities, state and local governments, private firms, and international organizations. While performing its mission, USACE capitalizes as CIP all costs associated with the initial construction of a capital asset as well as any addition and/or betterment to an existing capital asset. The USACE capitalizes General PP&E assets at historical acquisition cost plus capital improvements when an asset has a useful life of 2 or more years, and when the acquisition cost equals or exceeds $25 thousand.

USACE Financial Reporting Systems. USACE uses the Corps of Engineers Financial Management System (CEFMS) for the financial reporting of CIP. During FY 1998, USACE completed the deployment of CEFMS to all its divisions, districts, centers, laboratories, and field offices. CEFMS replaced the Corps of Engineers Management Information System (COEMIS).

Generally Accepted Accounting Principles (GAAP). The GAAP for the financial reporting of PP&E are provided in the Federal Accounting Standards Advisory Board's Statement of Federal Financial Accounting Standards No. 6, "Accounting for Property, Plant, and Equipment," June 1996. The GAAP define PP&E as tangible assets that meet all of the following criteria: have an estimated useful life of 2 or more years, are not intended for sale in the ordinary course of business, and are intended to be used or available for use by the entity. Constructed PP&E is required to be recorded as CIP until placed in service.

The GAAP define Federal tangible assets as items owned by the Federal Government, which would have probable economic benefits that can be obtained or controlled by a Federal Government entity. The GAAP define capitalization as recording and carrying forward expenditures for realization of benefits in one or more future periods. Expenses are defined as an outflow or depletion of assets during a specific period as a result of providing goods, rendering services, or

carrying out other activities related to an entity's programs and missions, the benefits from which do not extend beyond the present operating period.

DoD Accounting Policy for CIP. The DoD policy for the financial reporting of CIP is provided in DoD 7000.14-R, the DoD Financial Management Regulation, volume 4, chapter 6, "Accounting Policy and Procedures – Property, Plant & Equipment," August 2000. The DoD definition of PP&E is consistent with GAAP and also requires that the PP&E have an initial acquisition cost, book value, or fair market value that equals or exceeds the DoD capitalization threshold. The DoD Financial Management Regulation further states that for a constructed General PP&E asset, the cost to construct the asset shall be recorded as CIP until the asset is completed and available for use, whether or not it is actually placed in use at that time. According to the DoD Financial Management Regulation, the available-for-use date is not dependent on whether the constructed asset has been officially transferred or whether final payment has been made and the contract closed out. When the constructed asset is available for use, DoD policy requires that the balance recorded in the CIP account be transferred to the appropriate General PP&E account.

USACE Accounting Policy for CIP. The USACE policy for the financial reporting of CIP is provided in USACE memorandum, "Revised Capitalization Guidance for Civil Works Personal Property," September 29, 1997. The USACE policy requires that all costs associated with the initial construction of a capital asset and all costs associated with the construction of an addition and/or betterment to an existing capital asset will be capitalized as CIP. The policy provides the following examples of costs that should be capitalized as CIP: land acquisition costs, relocation costs, engineering and design costs, supervision and administration costs, and actual contract and in-house construction costs.

On the other hand, the policy states that costs for construction-related activities that do not result in the creation of a capital asset must be recorded as expenses. The USACE policy provides the following examples of expense-type activities that should not be capitalized as CIP: beach replenishment; excavation or dredging of channels in existing waterways; excavation or dredging of navigation ports and harbors; removal of trees, brush, or debris in existing waterways; special project reports; and feasibility studies (unless legislatively directed to be capitalized as CIP).

Objectives

Our overall audit assessment objective was to determine whether USACE, Civil Works, CIP assets were ready for audit. Specifically, we determined whether USACE had corrected the deficiencies we identified during FY 2003 and whether the financial reporting of CIP assets was consistent with GAAP. We also reviewed the management control program as it related to the audit objective. See Appendix A for a discussion of the scope and methodology, our review of the management control program, and prior coverage related to the objectives. See Appendix B for other matters of interest related to our coverage of the audit objectives.

A. Financial Reporting of CIP

USACE significantly improved its financial reporting of CIP during FY 2003 but deficiencies continued to exist, and CIP continued to be materially misstated. The CIP account had the following deficiencies;

- costs for non-USACE owned assets were reported as CIP,
- expense-type events were reported as CIP,
- costs for completed construction projects were not transferred out of CIP in the proper accounting period, and
- costs for valid USACE-owned CIP could not be supported by originating source data.

These problems existed because USACE actions to correct previously identified deficiencies with CIP financial reporting were incomplete, and USACE accounting policy did not conform with GAAP. As a result, the $3.8 billion beginning balance for CIP in the FY 2004 USACE financial statements was overstated by $640 million and an additional $188 million was unsupported. Continued CIP account deficiencies will preclude USACE from gaining a favorable audit opinion on its financial statements.

Improvements to CIP Financial Reporting

FY 2003 Corrective Actions. During our prior audit, we informed USACE that the FY 2003 USACE CIP beginning balance was materially overstated.[1] USACE initiated aggressive corrective actions to correct deficiencies in the CIP account. USACE internal review auditors monitored and assisted USACE program managers and accountants as they cleansed the CIP accounts through September 30, 2003.

USACE subsequently reported a CIP ending balance of $3.8 billion on its FY 2003 Financial Statements. This represented a $6.2 billion reduction from the $10.0 billion CIP ending balance reported on the USACE FY 2002 Financial Statements. However, USACE did not reclassify costs for expense-type events involving bank stabilization work, fish mitigation studies, or non-Federal cost share projects in the CEFMS subsidiary ledgers. Instead, USACE processed journal vouchers to make statement-level adjustments to the FY 2003 CIP balance. Specifically, USACE made a $3.7 billion adjustment to remove costs for non-Federal cost share projects and another $256 million adjustment to remove costs for fish mitigation studies. USACE did not take any actions to remove costs involving bank stabilization work from the CIP account.

[1] Inspector General, DoD, report number D-2004-017, "Reliability of Construction-in-Progress in the U.S. Army Corps of Engineers, Civil Works, Financial Statements," November 7, 2003.

USACE also reported CIP with negative balances totaling $41 million in FY 2002. USACE reduced the negative balance to $1 million in FY 2003. In addition, USACE developed a report in CEFMS that links CIP values to the applicable source documents. These USACE corrective actions resulted in significant improvements to the financial reporting of CIP.

FY 2004 Corrective Actions. We provided interim audit results to USACE in March 2004. USACE took action to further improve its accounting policy for CIP and developed a comprehensive FY 2004 CIP Information Paper to address our audit concerns. The CIP Information Paper describes the deficiencies identified in the CIP account and provides the necessary corrective actions to be implemented by USACE field activities that report CIP. Specifically, the CIP Information Paper addresses the following issues;

- proper accounting for non-Federal cost share projects (projects that will not be USACE owned upon completion),
- proper treatment of fish mitigation studies,
- proper treatment of bank stabilization projects,
- proper classification of capitalized versus expense costs,
- timely closeout of completed projects,
- supporting documentation for older pre-CEFMS projects,
- review of funded work items remaining in the CEFMS CIP account that originated in COEMIS, and
- correction of negative CIP balances and imbalances between CIP general ledgers and cost records.

The CIP Information Paper requires that all corrective actions be completed by October 31, 2004. If properly implemented, the CIP Information Paper should correct the significant deficiencies we have identified in the CIP account.

CIP Assets Reviewed

We tested the FY 2004 CIP beginning balance to determine the amount of progress that USACE made in reporting CIP. We selected a statistical sample of 336 items, valued at $2.7 billion, from the population of CIP assets comprising the $3.8 billion CIP value reported on the FY 2003 USACE financial statements. A sample item could include separable asset elements. Therefore, a sampled CIP asset could have portions that were valid and portions that were in error. Table 1 shows a summary of the audit results for the 336 sample items by audit conclusion.

Table 1. Audit Results for 336 Statistical Sample Items ($ in millions)

Audit Conclusion	No. Items	CIP Value	Amount Misstated	Amount Not Supported[1]
Owned by non-Federal Agencies	88	$ 374	$374	$0
Owned by Other Federal Agencies	17	94	24	0
USACE Expense-Type Events	37	717	121	0
USACE Completed Assets	33	186	121	0
USACE Fish Mitigation Studies[2]	40	175	0	0
USACE-Owned Valid CIP	121	1,158	0	188
Total	**336**	**$2,704**	**$640**	**$188**

[1]The amount not supported was only summarized for valid CIP that was owned by USACE
[2]All $175 million CIP involving fish mitigation studies was misstated. However, the balance is included as part of $536 million of erroneous fish mitigation studies discussed in Finding B.

We also tested the accuracy of the USACE journal voucher that removed $3.7 billion of costs for non-Federal cost share projects from the FY 2003 CIP financial statement balance. This test involved a random sample of 45 projects. The purpose of this test was to assess the controls over the methodology USACE used to identify and remove CIP that would be transferred to a non-Federal agency upon completion. USACE representatives explained that their journal voucher included all CIP assets identified by a CEFMS non-Federal cost share control number data element. We tested the accuracy of this data element using a pass/fail methodology that did not involve dollar values. See Appendix A for details on the statistical sampling plan and results. Appendix C contains a list of the total sample items reviewed, broken out by USACE activity.

CIP Not Owned By USACE

A significant portion of the USACE mission is to provide engineering and construction management support for other agencies, which sometimes share a portion of the project cost. Projects that will be transferred to non-Federal agencies upon completion are referred to as non-Federal cost share projects. USACE uses its CIP account to accumulate labor, material, and overhead costs for these projects. Upon completion, USACE transfers the constructed property to the applicable agency that shared a portion of the costs. The constructed property is not recorded as USACE General PP&E and does not result in a future economic benefit to USACE. Existing USACE accounting policy did not conform with GAAP and did not address the accounting treatment for CIP that would not be owned by USACE upon completion.

Ownership by Non-Federal Agencies. USACE did not identify all CIP assets that would be transferred to non-Federal agencies upon completion when it

processed a journal voucher to remove $3.7 billion of costs for non-Federal cost share projects from CIP. In the audit sample, 88 items, valued at $374 million, will be turned over to non-Federal cost share agencies upon completion.

For example, our sample included 12 items with CIP costs totaling $52 million for the Mississippi River Levee Project at the Vicksburg District. The completed assets will be transferred by USACE to State Levee Boards in Arkansas, Mississippi and Louisiana for operation and maintenance. The Mississippi River Levee Project is for flood control of the Mississippi river and its associated tributaries. The project consists of raising, strengthening and extending levees to provide protection against flooding. The non-Federal portion consists primarily of costs that the levee districts incur for land easement rights. This project does not involve the construction of any assets that will be owned or that will provide future economic benefits to USACE. These projects should not be recorded as CIP on the USACE financial statements.

Ownership by Other Federal Agencies. In the audit sample, 17 items, valued at $94 million, will be turned over to other Federal agencies upon completion. These assets do not economically benefit USACE but do result in assets to the Federal government. USACE did not properly disclose the nature and value of these projects in its financial statements.

For example, there were seven items valued at $32 million that involved construction of the Kentucky Lock and Dam at the USACE Nashville District. Upon completion, USACE will transfer the Kentucky Lock and Dam to the Tennessee Valley Authority. The Tennessee Valley Authority is a wholly owned corporate agency and instrumentality of the United States created by Congress in 1933 to provide navigation, flood control, agricultural and industrial development, and electrical power to the Tennessee Valley region. The USACE FY 2003 financial statements did not include any reference to the Kentucky Lock and Dam project or that it would be turned over to the Tennessee Valley Authority upon completion. USACE should disclose the portion of its CIP balance that will be turned over to other Federal agencies upon completion in the notes to its financial statements. In addition, USACE should coordinate with the receiving agency to ensure that the receiving agency is not also reporting the same CIP on its financial statements. Duplicate reporting would overstate the CIP balance reported on the Government-wide financial statements

There were 3 of the 17 items, valued at $24 million, involving work for the benefit of other Federal agencies that did not result in the construction of capital assets. These costs should not have been recorded as CIP but should have been expensed in the period incurred. Two of the items involved payments to the Tennessee Valley Authority for the relocation of existing transmission towers it owned. The third item involved bank stabilization work performed for the National Park Service.

Sample of Non-Federal Cost Share Projects. The USACE journal voucher to remove costs for non-Federal cost share projects from CIP erroneously included assets that will become USACE General PP&E upon completion. Of 45 projects sampled, eight will be placed in service by USACE upon completion and not transferred to a non-Federal agency. Based on the auditing guidelines

established by the Government Accountability Office (GAO), one error in a sample of 45 indicates a control weakness.[2]

For example, one project at the USACE Kansas City District (identified by Army Management Structure Code 017560) involved costs for the replacement of governor pumps, motors, and controls at the USACE-owned Stockton Power Plant. A non-Federal cost share control number was established in CEFMS for this project because all associated costs were funded by the City Water and Light Plant of the City of Jonesboro, Arkansas. However, all assets related to the project will be placed in service as USACE General PP&E upon completion and should have remained as part of the CIP balance reported on the USACE FY 2003 Financial Statements. Because USACE cannot rely on the non-Federal cost share control number to accurately identify CIP that will be transferred to non-Federal agencies upon completion, a comprehensive review of all CIP must be performed to determine the ultimate ownership.

Reporting Expense-Type Events as CIP

USACE activities were still reporting expense-type events as CIP. For 37 sample items, CIP values totaling $121 million involved expense-type events that were improperly reported (capitalized) as CIP. Table 2 shows a breakout of the expense-type events. These expense-type events do not result in the creation of capital assets and should not be reported as CIP. Existing USACE accounting policy did not conform with GAAP and did not address the accounting treatment for these expense-type events. USACE needs to review the CIP account and remove all costs involving expense-type events.

Table 2. Breakout of Expense-Type Events Recorded as CIP

Expense-Type Event	No. Items	Amount of CIP balance in Error (in millions)
Wildlife Mitigation Land	5	$ 80
Bank Stabilization Work	6	36
Miscellaneous	26	5
Total	**37**	**$121**

Wildlife Mitigation Land. For five sample items, USACE activities inappropriately reported $80 million of costs for the purchase and development of wildlife mitigation land as CIP. This occurred because USACE accounting policy did not follow GAAP for these types of costs. Specifically, these costs were considered to be in error for two reasons.

[2] General Accounting Office / President's Council on Integrity & Efficiency, "Financial Audit Manual (GAO-01-765G)," July 2001. The legal name for the General Accounting Office became the Government Accountability Office effective July 7, 2004.

First, a portion of the costs involved the USACE purchase of land for fish and wildlife mitigation purposes. These costs should not be reported as CIP but should be expensed and reported as Stewardship Land as set forth in the Federal Accounting Standards Advisory Board Statement of Federal Financial Accounting Standard Number 8, "Required Supplementary Stewardship Reporting." Specifically, the standard defines stewardship land as land and land rights owned by the Federal Government and not acquired for or in connection with General PP&E. According to the standard, examples of stewardship land include land used as forests and parks and land used for wildlife and grazing. The standard states that the cost of stewardship land, as well as associated costs to prepare the land for its intended use (e.g., razing a building), shall be expensed in the period incurred.

Second, a portion of the costs involved mitigation-type work performed by USACE on land owned by other agencies. Costs for assets that will not be placed in service as USACE General PP&E upon completion should be expensed as set forth in GAAP. These costs should be reported as non-Federal Physical property as set forth in the Federal Accounting Standards Advisory Board's Statement of Federal Financial Accounting Standard Number 8, "Required Supplementary Stewardship Reporting." Specifically, investments in non-Federal physical property refers to those expenses incurred by the Federal Government for the purchase, construction, or major renovation of physical property owned by state and local governments, including major additions, alterations, and replacements; the purchase of major equipment; and the purchase or improvement of other physical assets. Expenses included in calculating net cost for non-Federal physical property programs should be reported as investments in required supplementary stewardship information accompanying the financial statements of the Federal Government and the separate reports of component units of the Federal Government responsible for such investments. Reporting should include data, in nominal dollars, on investments for the year being reported and for the preceding 4 years. Additional year data may also be reported if such data would provide better indications of the nature of the investment.

Bank Stabilization Work. For six sample items, USACE activities inappropriately reported $36 million in costs for stabilizing the banks of existing waterways as CIP. Bank stabilization involves fortifying the banks of existing waterways through the use of rocks (rip rap) or concrete mats (revetments). These events represent the maintenance of existing waterways and do not result in the construction of capital assets. For example, the USACE Memphis District reported $20 million of bank stabilization costs as CIP for two items that were part of the Channel Improvement Construction Project. The channel improvement project consists of stabilizing the banks of the Mississippi River to a desirable alignment and obtaining the most efficient flow characteristics for flood control and navigation. The bank stabilization costs should have been expensed when incurred. Existing USACE policy did not specifically identify bank stabilization work as an expense-type event.

Other Miscellaneous Expense-Type Events. For 26 sample items, USACE activities inappropriately reported $5 million of costs involving other miscellaneous expense-type events as CIP. These events did not result in the construction of USACE capital assets and included cash awards, routine operation

and maintenance costs, late payment interest, and other miscellaneous expense-type events.

Transfer of Completed Projects

USACE activities did not transfer costs for completed construction projects out of the CIP account in the proper accounting period. For 33 sample items, CIP values totaling $121 million were related to projects completed prior to September 30, 2003. The costs for the completed assets should have been transferred out of the CIP account and placed in service as USACE real property. For example, a sample item at the USACE Portland District (identified by fund account number G212884) involved three separate capital improvement projects at the USACE Dalles Dam. The September 30, 2003, CIP balance was $5.6 million. Capital improvements totaling $5.5 million were completed prior to September 30, 2003, and should have been transferred out of CIP and placed in service. Specifically, one of the capital improvement projects valued at $2.7 million was completed in August 2000 and another capital improvement project valued at $2.8 million was completed in August 2001.

Support for CIP Values

USACE made significant improvements in supporting CIP values with originating source data. Of the 121 items with approximately $1.2 billion of valid USACE-owned CIP, USACE activities provided source data to support $969 million of the value. Despite the significant progress, USACE was unable to provide all of the documentation needed to support the CIP values. Specifically, USACE was unable to provide source data to support $188 million of the $1.2 billion CIP value. Originating source data was required to support the CIP values because a recent review by the GAO in coordination with the U.S. Army Audit Agency determined that the CEFMS could not be relied on for financial statement auditing purposes.[3]

Unsupported CIP Originating in COEMIS. Approximately $184 million of the $188 million unsupported CIP value involved sample items with costs that were originally reported in COEMIS, which was the USACE financial management system prior to FY 1998. During FY 1998, USACE completed the deployment of CEFMS to all its divisions, districts, centers, laboratories, and field offices. As part of the deployment, the CIP values were transferred from COEMIS to CEFMS. For the work items that originated in COEMIS, USACE activities had difficulty identifying CIP values to originating source data in a timely manner.

The largest unsupported CIP balance originating in COEMIS involved costs for construction of the Elk Creek Dam at the USACE Portland District. The Portland District could not provide source data to support any of the $94 million CIP costs

[3] GAO Report Number GAO-02-589,"Corps of Engineers Making Improvements, But Weaknesses Continue," June 10, 2002.

that did not involve labor or capital interest. In 1987, construction of the Elk Creek Dam was stopped by a court injunction at about one-third of the dam design height. Since 1987, the only costs that have been incurred involve land management, maintenance, and fish passage operations.

On June 9, 2004, USACE and the Office of the Inspector General of the Department of Defense signed a memorandum of agreement regarding the support for recorded book cost of USACE Civil Works General PP&E. The agreement outlines acceptable support for CIP costs that originated in the COEMIS. The USACE agreed to establish and implement procedures by November 15, 2004, that require that COEMIS costs associated with assets still in CIP be supported before the associated assets are placed in service. The agreed upon procedures, if properly implemented, should significantly reduce the amount of unsupported CIP costs. The memorandum of agreement is included in the USACE FY 2004 CIP Information Paper.

Unsupported CIP Originating in CEFMS. Approximately $4 million of the $188 million unsupported CIP value involved sample items with costs that originated in CEFMS. The sample items that originated in CEFMS were generally better supported than those originating in COEMIS. Based on our prior audit results, USACE developed a standard report in CEFMS that identified CIP values to originating source documents. USACE should continue to use and improve the standard CEFMS report.

Conclusion

USACE significantly improved its financial reporting of CIP during FY 2003. However, deficiencies continued to exist and CIP continued to be materially misstated. The $3.8 billion USACE CIP account represents a material portion of the total assets reported on the USACE financial statements. The $640 million of misstated CIP costs identified by this report greatly exceeds the materiality threshold generally established for financial statement audits. Misclassified CIP costs impact the total assets and expenses reported on the USACE financial statements. In addition, for CIP assets that will remain as USACE property upon completion, the costs accumulated in CIP will serve as a basis for the value of the real property when it is placed in service. Therefore, it is imperative that CIP assets be presented in a manner consistent with GAAP. This will significantly aid USACE efforts to achieve a favorable audit opinion on its financial statements.

Recommendations, Management Comments, and Audit Response

A. We recommend that the Commander of the U.S. Army Corps of Engineers:

1. Ensure proper implementation of the FY 2004 Construction-in-Progress Information Paper requiring the following corrective actions:

a. Removal of costs for non-Federal cost share projects from the Construction-in-Progress account.

b. Removal of costs involving bank stabilization work from the Construction-in-Progress account.

c. Proper classification of capitalized versus expensed costs.

d. Timely closeout of completed projects.

e. Supporting documentation for older projects originating in the Corps of Engineers Management Information System.

f. Review of funded work items remaining in Corps of Engineers Financial Management System Construction-in-Progress account that originated in the Corps of Engineers Management Information System.

g. Correction of negative Construction-in-Progress balances and imbalances between Construction-in-Progress general ledgers and cost records.

Management Comments. The Commander of the U.S. Army Corps of Engineers concurred with the findings and recommendations. The Commander stated that the U.S. Army Corps of Engineers headquarters developed an information paper to ensure all corrective actions above are addressed. The information paper was reviewed by the Office of the Inspector General of the Department of Defense. The Commander stated that the expected completion date is October 31, 2004.

2. Disclose in the financial statements the portion of the Construction-in-Progress balance that will be turned over to other Federal agencies upon completion, and coordinate with the receiving agency to ensure that the receiving agency is not also reporting the same Construction-in-Progress balance on its financial statements.

Management Comments. The Commander of the U.S. Army Corps of Engineers concurred with the findings and recommendations. The Commander agreed to disclose in the FY 2004 financial statements the Construction-in Progress balance that will be turned over to other Federal agencies upon completion. He also agreed to coordinate with the receiving agency to avoid duplicate reporting.

3. Perform a comprehensive review of the Construction-in-Progress account and remove all costs involving the purchase or development of wildlife mitigation land. The related costs, as well as any future costs, should be expensed in the period incurred and reported as Stewardship Land on the Required Supplementary Stewardship Information Statement.

Management Comments. The Commander of the U.S. Army Corps of Engineers concurred with the findings and recommendations. The Commander agreed to perform a comprehensive review of the Construction-in-Progress account to determine the extent of wildlife mitigation work performed on Stewardship Land. However, the Commander did not provide an estimated completion date for the corrective action.

Audit Response. The corrective actions were responsive but the Commander needs to provide an estimated completion date.

B. Financial Reporting of Columbia River Fish Mitigation Program Costs

USACE did not properly account for costs involving the Columbia River Fish Mitigation Program (Columbia River Program). This occurred because USACE accounted for Columbia River Program costs based on its interpretation of a 1993 Senate Conference Report rather than GAAP. As a result, USACE overstated its FY 2004 CIP beginning balance by approximately $536 million. In addition, completed Columbia River Program work is accruing excessive capital interest charges.

Columbia River Program Background

USACE Role in the Columbia River Program. The Columbia River Program was initiated at the USACE Northwest Division in 1988 to improve fishways and bypass systems at the lower Columbia and Snake River dams. The Columbia River Program was necessary because the National Marine Fisheries Service listed twelve types of salmon and steelhead fish as threatened or endangered under the Endangered Species Act.

When a Federal agency's operations may affect species listed under the Endangered Species Act, that agency must consult with the listing agency on those operations. The listing agency then issues a biological opinion on the effect of the proposed operations. If the biological opinion finds that proposed agency actions would jeopardize the continued existence of the listed species, recommended measures to avoid jeopardy are proposed in a reasonable and prudent alternative.

USACE currently operates its dams based on biological opinions from the National Marine Fisheries Service for salmon and steelhead, and from the U.S. Fish and Wildlife Service for other Columbia River Basin species listed under the Endangered Species Act. The National Marine Fisheries Service Biological Opinions for salmon and steelhead require improvements to existing fish bypass systems at USACE dams.

Substantial funding for the Columbia River Program began in the Energy and Water Development Appropriation Bill of 1993 (Senate Report 102-344). In the bill, the Committee on Appropriations urged USACE to place greater emphasis on the development of improved technologies relating to the transportation, collection, and release of migrating juvenile salmon. The bill established specific guidance for dealing with Columbia River juvenile fish mitigation in the Pacific Northwest. USACE representatives estimated that the Columbia River Program would continue until at least FY 2010.

Bonneville Power Administration's Role in the Columbia River Program. The Bonneville Power Administration (BPA) is a federal agency, under the U.S. Department of Energy, that markets wholesale electrical power and operates and markets transmission services in the Pacific Northwest. The power comes from

31 Federal hydroelectric projects, one non-Federal nuclear power plant, and several other small non-Federal power plants. USACE owns and operates 21 of the 31 Federal hydroelectric projects used to provide power to BPA. The hydroelectric projects and the electrical system are known as the Federal Columbia River Power System. About 45 percent of the electric power used in the Northwest comes from BPA.

Construction and replacement of USACE power generating facilities historically have been financed through annual Federal Appropriations. BPA is a self-funding agency, which pays for its costs through power and transmission sales. Both power and transmission are sold at cost, and BPA repays any borrowing from the U.S. Treasury with interest. BPA must maintain sufficient revenues to repay the power investment in each Federal hydroelectric project, with interest, within 50 years after the project is placed in service. Additionally, BPA must maintain sufficient revenues to pay interest on the unrepaid investment in power facilities financed with appropriated funds. This responsibility includes recovering the costs for the Columbia River Program, which are also financed through annual Federal Appropriations.

BPA is responsible for preserving the balance and the economic and environmental benefits of the Federal Columbia River Power System, which includes the accounts of USACE power generating facilities. BPA purchases, transmits, and markets power for USACE. Each entity is separately managed and financed, but the facilities are operated as an integrated power system with combined financial results. The costs of multipurpose USACE projects are charged to specific projects through a cost allocation process. Only the portion of the total project costs allocated to power is included in BPA financial statements. USACE Districts are responsible for providing financial statements to BPA for each USACE hydroelectric facility included in the Federal Columbia River Power System.

USACE Financial Reporting of Columbia River Program Costs

USACE Policy on Reporting Columbia River Program Costs. The USACE capitalization policy does not specifically address Columbia River Program costs. However, USACE headquarters issued a policy memorandum to the Commander of the North Pacific Division: "Accounting Policy for the Columbia River Juvenile Fish Mitigation: WA, OR and ID," June 2, 1995. The memorandum stated that in keeping with the intent of the Senate Report Language, fish mitigation analysis costs should be considered CIP until the mitigation analysis is considered complete. The memorandum also stated that upon completion of the mitigation analysis, an equitable share of the capitalized fish mitigation analysis costs will be immediately allocated to all portions of the projects involved.

Senate report language from the Energy and Water Development Appropriation Bill of 1993 (Senate Report 102-344) established guidance for dealing with Columbia River juvenile fish mitigation in the Pacific Northwest. Specifically,

the bill addressed a test drawdown of the Lower Granite and Lower Goose Reservoirs in 1992 and the lowering of John Day Reservoir as follows:

> Columbia River juvenile fish mitigation, Washington, Oregon, and Idaho. The Committee has included $2,000,000 in the bill to compensate for direct damages to public and private property resulting from the test drawdown of the Lower Granite and Little Goose Reservoirs in March 1992. The Committee emphasizes that this does not create a precedent for how costs associated with any future drawdown or other fish mitigation effort in the Columbia River basin will be paid for or allocated. In addition, the Committee encourages the implementation of a regional solution to the salmon crisis which identifies a method of paying for recovery measures spread equitably among the various river user groups.
>
> The regional salmon recovery program developed in the Pacific Northwest calls for lowering John Day Reservoir to speed juvenile fish migration and reduce predation. Current studies by the Corps of Engineers evaluate facility modifications and impact mitigation requirements associated with this juvenile fish mitigation activity. The Committee includes $2,000,000 for advanced planning and design and other activities that enable continued progress toward operation of John Day Reservoir at minimum operating pool during juvenile fish migration. Obligation of these funds should be consistent with the findings of the Corps' study, to be completed in November 1992, that will evaluate impacts on other uses and resources including a hatchery facility and a wildlife refuge. Consistent with current policy, the costs of this activity shall not be allocated until conclusion of the mitigation analysis.

Subsequent Energy and Water Development Appropriations Bills between 1995 and 2004 do not address how Columbia River Program costs should be accounted for or reported. However, the Columbia River Program costs maintained in the USACE CIP account escalated from the $4 million allocated in 1993 to $649 million at the end of FY 2003. The additional costs involved studies and prototypes that expanded well beyond the scope of the initial drawdown studies at the Lower Granite, Little Goose, and John Day Reservoirs.

FY 2003 Financial Statement Presentation of Columbia River Program Costs. The September 30, 2003, USACE financial ledgers for CIP included $649 million of costs for the Columbia River Program. During our audit of the FY 2003 beginning CIP balance, we identified sample items containing approximately $256 million of Columbia River Program costs that were originally recorded in COEMIS. In order to provide a more conservative CIP balance on the financial statements, USACE made a statement-level adjustment to reduce the CIP balance reported in their FY 2003 financial statements by $256 million. However, the CIP costs were never removed from the CIP subsidiary financial ledgers. USACE did not provide any disclosures in the notes to the financial statements to describe the reimbursable nature of the Columbia River Program assets or the power marketing relationship with BPA.

Assessment of Columbia River Program Costs

USACE did not properly account for approximately $536 million of the $649 million of costs involving the Columbia River Program. Specifically, the misreported Columbia River Program costs did not involve the construction of capital assets but were reported as CIP. Table 3 shows a breakout of the misreported Columbia River Program costs.

Table 3. Breakout of Misreported Columbia River Program Costs

Category of Columbia River Program Costs	CIP Balance (in millions)
Studies, Prototypes & Management Costs in Audit Sample	$175
Completed Studies Included in USACE Journal Voucher	256
Studies & Prototypes Identified in Remaining Population	105
Total	**$536**

Audit Sample Results. To assess the $3.8 billion CIP beginning balance for the USACE, Civil Works, FY 2004 Principal Financial Statements, we sampled 336 items valued at $2.7 billion. Included in this sample were 48 items, valued at $226 million, involving the Columbia River Program. The USACE Northwest Division, through its Portland and Walla Walla Districts, reported a variety of Columbia River Program costs as USACE CIP. The Columbia River Program costs reported as CIP included on-going studies, completed studies, prototypes, program management, and real property construction. Of the 48 Columbia River Program items, 40 items valued at $175 million involved studies, prototypes and program management costs that should not have been reported as CIP. However, the portion of these costs related to hydroelectric power are required to be reimbursed by BPA and will result in a future economic benefit to the Federal Government. USACE will have to research these costs and determine the reimbursable amounts. The reimbursable Columbia River Program costs should be reported in a general ledger asset account other than CIP. The non-reimbursable costs should be expensed. The remaining eight items, valued at $51 million, involved the construction of real property assets.

Studies, Prototypes and Program Management Costs. USACE reported $175 million of Columbia River Program costs involving research, studies, prototypes, and overall program management as CIP. However, these costs did not meet the capitalization criteria set forth by GAAP. For example, a sample item at the USACE Portland District (identified by fund account number G227485) involved a prototype upper turbine fish block established at the USACE Dalles Dam in 1995. The prototype was tested in FY 2000 and FY 2001 and was found to be ineffective. The prototype was not intended to be a permanent fixture of the Dam and has been hoisted out of the water and is not in operation. However, the $6.7 million cost for the prototype was reported as CIP on September 30, 2003.

Construction of Real Property Assets. Of the 48 sample items, 8 items valued at $51 million involved the construction of real property assets. Seven of the items represented valid CIP as of September 30, 2003, and one item was completed in February 2003 and should not have been included in the CIP balance. These eight CIP assets are addressed in finding A of this report under the categories of USACE-owned valid CIP and USACE completed assets, respectively.

Completed Studies in USACE Journal Voucher. The $256 million USACE journal voucher to reduce the CIP balance reported in its FY 2003 financial statements involved completed fish mitigation studies. This was only a statement-level adjustment and the applicable costs were never removed from the CIP subsidiary financial ledgers. USACE will have to research these costs and determine the reimbursable amounts. The reimbursable Columbia River Program costs should be reported in a general ledger asset account other than CIP. The non-reimbursable costs should be expensed.

Studies and Prototypes Identified in Remaining Columbia River Program Population. Of the $167 million remaining CIP balance for Columbia River Program costs, approximately $105 million of the costs were described in CEFMS as studies or prototypes. USACE will also have to research these costs and properly report the reimbursable and non-reimbursable amounts.

Interest During Construction

USACE Policy on Accruing Capital Interest. The USACE Engineering Regulation 37-2-10, Chapter 14, "Accounting Treatment for Multi-Purpose Projects," December 31, 2003, provides guidance on the accounting treatment for field activities that operate multi-purpose hydroelectric projects that furnish electricity for resale to the public. A multi-purpose power project is one that serves more than one function (hydroelectric power, navigation improvement, flood control) and is authorized by congress. Generally, construction, operations, and maintenance costs at projects for power, irrigation, and/or water supply purposes are reimbursable. Costs for generating hydroelectric power are recovered through the marketing and selling of power to commercial activities. Power Marketing Agencies (including BPA), under the Department of Energy, perform this function. These agencies bill and collect funds for electricity sold and funds are deposited on behalf of USACE. According to the policy, costs include: repayment of construction costs; interest during construction; interest to operations; and annual operation and maintenance expenses. The construction phase is initiated when land is purchased or a construction contract is awarded, whichever occurs first. Interest during construction (capital interest) is required to be maintained in the CIP account until the asset is completed and placed in service. At the end of the year prior to completion, the interest obligation shall be added to the cost of the facility to be charged interest for subsequent periods. Upon completion, the applicable portion of the interest, together with the other costs representing the completed asset, will be transferred to the appropriate plant in service account. The interest rate will be the authorized rate at the time construction begins.

Columbia River Program Capital Interest Charges. Excessive capital interest charges were accruing for completed Columbia River Program items. The Columbia River Program is classified as a multi-purpose project for which capital interest is calculated as long as the costs reside in the CIP account. The continued compounding of capital interest for completed items inflates the CIP values that will eventually have to be reimbursed by BPA through their rates. For example, a sample item at the USACE Portland District (identified by fund account number G213596) involved a fish study at the Bonneville Dam. No CIP costs other than capital interest have been incurred since FY 2000. The FY 2003 CIP balance was $5.4 million and the accumulated capital interest through FY 2003 was $1.5 million. Based on the current USACE methodology, the estimated CIP balance at the end of FY 2010 will be $7.7 million, of which the capital interest will be $3.3 million, or about 43 percent of the total CIP balance for this fund account number.

The CEFMS detailed cost ledgers showed that at the end of FY 2003 approximately $100 million of capital interest had accumulated in the CIP account for the Columbia River Program. This represented 16 percent of the total $649 million Columbia River Program. Based on current USACE methodology, the capital interest will continue to accumulate for all CIP items until the completion of the entire Columbia River Program, which is currently estimated at FY 2010. Based on an average of the historical rates used to compute capital interest for the Columbia River Program and the current $649 million CIP value, we estimate that total capital interest of $368 million will accrue through completion of the Columbia River Program in FY 2010.

USACE Corrective Actions

In March 2004, we met with USACE headquarters and GAO personnel to discuss concerns with the financial reporting of Columbia River Program costs. USACE officials agreed with the position reached by our audit team and GAO, that Columbia River Program costs that do not result in the creation of a capital asset should not be reported as USACE CIP. However, the reimbursable portion of these costs relating to power production represent an asset to the Federal Government because they are required to be reimbursed through BPA power rates. USACE developed a comprehensive CIP Information Paper to address our audit concerns. The CIP Information Paper describes deficiencies identified with the financial reporting of Columbia River Program costs and provides the following corrective actions to be implemented by USACE headquarters and field activities by October 31, 2004:

- USACE Northwest Division personnel shall determine the costs allocation at the project (macro) and purpose (micro) levels. Upon completing the analysis, costs belonging to non-Power features should either be placed in service or expensed depending on the situation.

- USACE headquarters will determine which standard general ledger account should be used to collect costs until the fish mitigation project is complete.

- USACE headquarters will update the appropriate Congressional committees on the current amount of unallocated Columbia River Program costs and determine if the 1993 Senate Report language is still applicable.

Conclusion

A comprehensive review of the Columbia River Program costs is necessary to determine which costs represent valid CIP, which costs represent reimbursable assets involving hydroelectric power, and which costs are non-reimbursable and should therefore be expensed. The Columbia River Program costs that do not ultimately result in the creation of a capital asset should not be reported as CIP. We are encouraged that USACE plans to update the Congressional Committees on the current portion of unallocated Columbia River Program costs. The Committee stated in the 1993 conference report that the $4 million of original Columbia River Program costs should not be allocated until completion of the initial draw down studies. However, $645 million of Columbia River Program costs have accrued in the CIP account since that time and need to be reported in a manner consistent with GAAP. Additionally, we are concerned with the excessive capital interest charges that have accrued and will continue to do so until FY 2010. USACE should discontinue accruing capital interest for completed Columbia River Program work.

Recommendations, Management Comments, and Audit Response

B. We recommend that the Commander of the U.S. Army Corps of Engineers:

1. Ensure proper implementation of the FY 2004 Construction-in-Progress Information Paper requiring corrective actions for Columbia River Fish Mitigation Program costs.

Management Comments. The Commander of the U.S. Army Corps of Engineers concurred with the finding and recommendation. The Commander stated that the U.S. Army Corps of Engineers headquarters developed an information paper to ensure all corrective actions above are addressed. The information paper was reviewed by the Office of the Inspector General of the Department of Defense. The Commander stated that the expected completion date is October 31, 2004.

2. Discontinue accruing capital interest for completed Columbia River Fish Mitigation Program work.

Management Comments. The Commander of the U.S. Army Corps of Engineers concurred with the finding and recommendation. In addition, the Commander stated that his Civil Works Directorate was working with

Congressional staff to develop a plan for reporting Hydropower-related costs. The Commander also agreed to ensure that the financial statements are adjusted to exclude the accrued interest for completed Columbia River Fish Mitigation Program work. However, the Commander did not provide an estimated completion date for the corrective actions.

Audit Response. The corrective actions were responsive but the Commander needs to provide an estimated completion date. In addition, we request that the Commander provide the plan for reporting Hydropower-related costs that results from the coordination with Congressional staff.

Appendix A. Scope and Methodology

The audit assessment was performed to meet the requirements of Public Law 101-576, the "Chief Financial Officers Act of 1990," November 15, 1990, as amended by Public Law 103-356, the "Federal Financial Management Act of 1994," October 13, 1994 and the National Defense Authorization Act of 2002. For this part of the audit assessment, we determined whether USACE had corrected the deficiencies we identified during FY 2003 and whether CIP assets were reported in a manner consistent with GAAP. This is consistent with the National Defense Authorization Act of 2002, as resources are directed towards identifying and improving financial management policies, procedures, and internal controls.

We performed the audit at USACE headquarters and field locations. Specifically, we analyzed the CIP values for a statistical sample of 336 items, valued at $2.7 billion, and a random sample of 45 non-Federal cost share projects. We accomplished our audit at 38 USACE activities using a combination of site visits and data call methodology. We determined whether the CIP values were accurately reported and were supported by originating source data. In addition, we performed a review of CIP costs involving the Columbia River Program, including the calculation of interest during construction.

We used statistical sampling methods to test USACE management assertions regarding the valuation and existence of the CIP account. We interviewed USACE Project Managers and Resource Management personnel at each activity to obtain background and status on each project reviewed. We also reviewed project fact sheets, pictures, and other related documentation for the various projects. Additionally, we reviewed all applicable documentation supporting the CIP values including, but not limited to: contractor pay estimates, contractor invoices, travel voucher settlements, and Military Interdepartmental Purchase Requests.

Our primary objectives involved validating that CIP costs:

- were being incurred for assets that would be placed in service as USACE General PP&E upon completion,
- involved on-going construction at September 30, 2003,
- represented costs that should be capitalized based on the guidelines set forth by GAAP rather than expense-type events, and
- could be verified to originating source documentation.

Our scope was limited in that we did not physically verify the existence or completeness of the CIP assets. In addition, we did not validate all labor and overhead values or the capital interest calculations for each CIP project. We performed additional limited tests on labor and capital interest calculations. Also, because of the significant amount of source data required to support the CIP assets, we primarily reviewed source data supporting individual costs exceeding

one thousand dollars. We performed this audit from October 2003 through August 2004 based on generally accepted government auditing standards.

USACE provided a universe of CIP assets extracted from CEFMS on September 30, 2003. The CIP assets each represented the accumulation of capitalized CIP costs identified by a unique CEFMS funding account number. We reconciled the CIP universe provided by USACE to the CIP balance reported on the financial ledgers for the corresponding time period. We removed CIP assets with negative values from the sample population. We considered all negative balance items as errors because assets should not have negative balances. We established two sample populations based on the methodology used by USACE to report the CIP value on the FY 2003 financial statements.

Sample Design. The Inspector General, DoD, Quantitative Methods Division used a stratified variable sampling methodology to select a statistical sample of CIP assets from a universe of 7,123 CIP assets valued at $3.8 billion. The sample was composed of 336 CIP assets, valued at $2.7 billion. Appendix C provides a breakout of the 336 sample items and CIP value by USACE activity reviewed. In addition, the Inspector General, DoD, Quantitative Methods Division selected a random sample of 45 non-Federal cost share projects from the population of 489 CIP projects that comprised the $3.7 billion USACE journal voucher to remove costs for non-Federal cost share projects from the FY 2003 CIP financial statement balance.

Sample Results. We did not project the results of our statistical sample because the magnitude of errors identified in the $2.7 billion CIP balance for the 336 sample items reviewed was sufficient to show that the CIP account was materially misstated. Specifically, $815 million of the $2.7 billion CIP costs were found to be in error and should not have been reported as USACE CIP. Of the $815 million, $640 million involved costs for assets owned by non-Federal agencies, costs for completed assets, and costs for expense-type events, that are reported in Finding A of this report. The remaining $175 million involved Columbia River Program costs that are reported in Finding B of this report.

Of the 45 non-Federal cost share projects randomly sampled, eight failed the control test because the costs would be placed in service by USACE upon completion and not transferred to a non-Federal agency. Because this control sample did not involve dollar values, we cannot determine the overall impact on the USACE journal voucher to remove $3.7 billion costs for non-Federal cost share projects from the FY 2003 CIP financial statement balance.

Use of Computer-Processed Data. We relied on computer-processed data from CEFMS to determine the September 30, 2003, CIP universe for statistical sampling purposes. We did not test the CEFMS general and application controls. We were able to reconcile the September 30, 2003, CEFMS CIP universe to the USACE trial balance for the corresponding period without a material variance. Additionally, we performed other tests on the data to determine the accuracy and reliability of the CIP account balance. For our audit, we required the originating source data to support the CIP values reported in CEFMS. This was necessary because recent reviews by the Government Accountability Office and the U.S.

Army Audit Agency determined that the CEFMS could not be relied on for financial statement auditing purposes.

Use of Technical Assistance. The Inspector General, DoD, Quantitative Methods Division provided assistance in developing the statistical sample and calculating the statistical projections.

GAO High-Risk Area. The GAO has identified several high-risk areas in DoD. This report provides coverage of the Financial Management high-risk area.

Management Control Program Review

DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996, and DoD Instruction 5010.40, "Management Control (MC) Program Procedures," August 28, 1996, require DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of the Review of the Management Control Program. We reviewed the adequacy of USACE management controls over the financial reporting of CIP. We reviewed management's self-evaluation applicable to those controls. We reviewed the FY 2003 Annual Statement of Assurance issued by USACE to determine whether the issues addressed in this report involving the financial reporting of CIP had been reported as material management control weaknesses.

Adequacy of Management Controls. We identified material management control weaknesses, as defined by DoD Instruction 5010.40, related to the financial reporting of CIP. Specifically, the $3.8 billion beginning balance for CIP in the USACE FY 2004 Financial Statements was overstated by $640 million and an additional $188 million was unsupported. Also, USACE did not properly account for $536 million of Columbia River Program costs. The details of the management control weaknesses are provided in detail in the Finding sections of this report. All of the recommendations in this report, if implemented, will improve the accuracy and reliability of USACE financial reporting of CIP. A copy of the report will be provided to the senior official responsible for USACE management controls.

Adequacy of Management's Self-Evaluation. USACE officials did not identify CIP financial reporting as an assessable unit and, therefore, did not identify or report the material management control weaknesses identified by the audit.

Prior Coverage

During the last 5 years, GAO and the Inspector General of the Department of Defense (IG DoD) have issued 3 reports discussing the USACE financial reporting of CIP and related CEFMS controls. Unrestricted GAO reports can be

accessed over the Internet at http://www.gao.gov. Unrestricted IG DoD reports can be accessed at http://www.dodig.osd.mil/audit/reports.

GAO

GAO Report No. GAO-02-589, "Corps of Engineers Making Improvements, But Weaknesses Continue," June 10, 2002

IG DoD

IG DoD Report No. D-2004-017, "Reliability of Construction-in-Progress in the U.S. Army Corps of Engineers, Civil Works, Financial Statements," November 7, 2003

Appendix B. Other Matters of Interest

During our review we identified the following problems with the USACE CIP account that were limited in number and value. However, because our review was not designed to specifically identify these issues, we do not know the extent of their existence in the overall population of USACE CIP.

COEMIS to CEFMS Conversion. For a limited number of sample items with costs that originated in COEMIS, USACE activities were able to provide the final COEMIS cost ledger prior to the conversion to CEFMS. We reconciled the final COEMIS cost ledger to the initial CEFMS cost ledger to determine if all CIP costs were properly converted. We found that for two items, USACE activities did not properly transfer all applicable costs. As a result, the CIP balance for two sample items was understated by $3.4 million. One item was from the Huntington District and the other item was from the Nashville District. A memorandum of agreement signed by USACE and the Office of the Inspector General of the Department of Defense, on July 9, 2004, addresses the support for recorded book cost of USACE Civil Works General PP&E. Specifically, USACE activities will be required to analyze and support costs that originated in COEMIS and should be able to ensure that all costs were properly converted to CEFMS.

Capital Interest. USACE Omaha and Portland Districts did not properly calculate capital interest for CIP projects. During our review at the Omaha District we found that two items, fund account numbers C217462 and C217931 had negative cumulative capital interest of $855,280 and $22,361, respectively. Omaha District personnel stated that the negative balances arose from a programming problem in FY 2000. The CEFMS Interest Detail Report did not run for the Omaha Multi-Purpose Projects in FY 1999 and ran improperly in FY 2000. USACE headquarters ran the report in FY 2000 but a programming problem created negative interest in many of the Multi-Purpose Projects. The Omaha District was working with USACE headquarters to identify and correct the capital interest balances for the applicable CIP items.

During our review at the Portland District we identified seven sample items that did not have any capital interest. In addition, we identified 28 sample items that did not contain any capital interest for the month of September 2003. Upon further review, Portland discovered that capital interest was not properly applied to more than 263 CIP items between May 2003 and September 2003. Portland District personnel were unable to determine why the capital interest was not calculated for the items and is currently working with the USACE headquarters to identify and correct capital interest for all Multi-Purpose Projects.

Abnormal CIP Balances. Our review of the September 30, 2003, CEFMS subsidiary ledgers identified CIP assets with negative balances of $1 million. This represented a significant reduction from the $41 million negative CIP in the September 30, 2002, CEFMS subsidiary ledgers. However, no asset accounts should have negative balances. In addition, for 93 records the CIP subsidiary balance exceeded the CIP general ledger balance by $4.3 million. The FY 2004 CIP Information Paper required USACE activities to identify and correct abnormal CIP balances.

Appendix C. Breakout of Audit Sample Items by Activity Reviewed

USACE Activity Reviewed	No. of Random Sample Items	No. of Statistical Sample Items	CIP Value
Louisville District	2	49	$662,834,616
Portland District	2	51	437,038,172
Little Rock District	3	10	245,535,037
Pittsburgh District	3	11	216,087,429
Omaha District	2	14	120,302,223
Huntington District	1	11	114,728,667
Los Angeles District	1	12	102,758,785
Mobile District	0	9	102,304,941
Nashville District	2	18	96,670,902
Walla Walla District	0	29	85,596,496
Vicksburg District	3	25	82,055,556
Memphis District	0	6	69,983,061
Kansas City District	1	6	51,857,085
Tulsa District	3	7	45,577,821
New Orleans District	0	10	43,561,080
Sacramento District	1	9	33,108,363
New England District	0	4	27,754,880
Baltimore District	2	3	19,657,233
New York District	2	3	18,717,505
Washington Aqueduct	0	2	17,119,389
Seattle District	1	3	15,996,789
USACE Headquarters	0	4	15,672,104
Fort Worth District	1	4	14,859,809
Philadelphia District	0	6	13,483,384
Wilmington District	0	1	11,984,925
Chicago District	2	4	8,483,549
Rock Island District	0	6	8,390,938
St. Louis District	3	5	6,199,216
Honolulu District	0	1	4,948,096
Buffalo District	1	1	2,469,807
Jacksonville District	2	4	2,417,383
Savannah District	0	1	2,076,703
Albuquerque District	1	3	2,038,105
Charleston	0	1	903,203
St. Paul District	2	1	547,494
Detroit District	2	2	304,932
Alaska District	1	0	0
San Francisco District	1	0	0
Total	**45**	**336**	**$2,704,025,678**

Appendix D. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)/Chief Financial Officer
  Deputy Chief Financial Officer
  Deputy Comptroller (Program/Budget)

Department of the Army

Assistant Secretary of the Army (Financial Management and Comptroller)
Assistant Secretary of the Army (Civil Works)
Commander, U.S. Army Corps of Engineers
Auditor General, Department of the Army

Department of the Navy

Naval Inspector General
Auditor General, Department of the Navy

Department of the Air Force

Auditor General, Department of the Air Force

Non-Defense Federal Organization

Office of Management and Budget

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member (cont'd)

House Committee on Armed Services
House Committee on Government Reform
House Subcommittee on Government Efficiency and Financial Management, Committee on Government Reform
House Subcommittee on National Security, Emerging Threats, and International Relations, Committee on Government Reform
House Subcommittee on Technology, Information Policy, Intergovernmental Relations, and the Census, Committee on Government Reform

U.S. Army Corps of Engineers Comments

DEPARTMENT OF THE ARMY
U.S. ARMY CORPS OF ENGINEERS
441 G ST. NW
WASHINGTON, D.C. 20314-1000

CEIR (36-2b)

6 October 2004

MEMORANDUM FOR Director, Defense Financial Auditing Service, Inspector General Department of Defense. 400 Army Navy Drive, Arlington, VA 22202-4704

SUBJECT: Draft Report on Assessment of the U.S. Army Corps of Engineers, Civil Works, FY 2004 Beginning Financial Statement Balance of Construction-in-Progress (Project No. D2004FJ-0032)

1. The USACE response to each Department of Defense Inspector General (DoDIG) report recommendations follows:

2. **Finding A – We recommend that the Commander, U.S. Army Corps of Engineers:**

    1. Ensure proper implementation of the FY 2004 Construction-In-Progress Information Paper requiring the following corrective actions:

        a. Removal of costs for non-Federal cost share projects from the Construction-in-Progress account.

        b. Removal of costs involving bank stabilization work from the Construction-In-Progress account.

        c. Proper classification of capitalized versus expensed costs.

        d. Timely closeout of completed projects.

        e. Supporting documentation for older projects originating in the Corps of Engineers Management Information System.

        f. Review of funded work items remaining in Corps of Engineers Financial Management System Construction-in-Progress account that originated in the Corps of Engineers Management Information System.

g. Correction of negative Construction-In-Progress balances and imbalances between Construction-in-Progress general ledgers and cost records.

Concur:
HQ USACE has developed an information paper to ensure all corrective actions above are addressed. The paper was reviewed by DODIG. The expected completion date is October 31, 2004.

2. Disclose in the financial statements the portion of the Construction-in-Progress balance that will be turned over to other Federal agencies upon completion, and coordinate with the receiving agency to ensure that the receiving agency is not also reporting the same Construction-in-Progress balance on its financial statements.

Concur:
USACE will disclose in its FY 2004 Financial Statements - Note 10 the portion of the Construction-in-Progress balance that will be turned over to other Federal agencies upon completion. In addition, we will coordinate with the receiving agency to ensure duplication of Construction-in-Progress balances does not occur.

3. Perform a comprehensive review of the Construction-in-Progress account and remove all costs involving the purchase or development of wildlife mitigation land. The related costs, as well as any future costs, should be expensed in the period incurred and reported as Stewardship Land on the Required Supplementary Stewardship Information Statement.

Concur:
USACE plans to perform a comprehensive review of the Construction-in-Progress account to determine if there is any wildlife mitigation work being done on Stewardship Land. Currently USACE does not report Stewardship Land since all Land purchased by USACE has been determined to meet the definition in Federal Accounting Standard Accounting Board

Statement Number 8 Chapter 4 as being reportable as general Property Plant & Equipment.

"Stewardship Land - Land not acquired for or in connection with [FN22-"Acquired for or in connection with" is defined as including land acquired with the intent to construct general PP&E and land acquired in combination with general PP&E, including not only land used as the foundation, but also adjacent land considered to be the general PP&E's common grounds.]"

3. **Finding B – We recommend that the Commander, U.S. Army Corps of Engineers:**

1. Ensure proper implementation of the FY 2004 Construction-in-Progress Information Paper requiring corrective actions for Columbia River Fish Mitigation Program costs.

   Concur:
   HQ USACE has developed an information paper to ensure all corrective actions above are addressed. The paper was reviewed by DODIG. The expected completion date is October 31, 2004.

2. Discontinue accruing capital interest for completed Columbia River Fish Mitigation Program work.

   Concur:
   USACE agrees that under normal circumstances when work is completed interest during construction should discontinue. In the Columbia River Fish Mitigation Project we have received contrary Congressional Language we interpret requiring us to keep it in the CIP account until "conclusion of the mitigation analysis" which is scheduled to end in 2010. Our Civil Works Directorate is currently working with Congressional Staff to determine the best course of action. Once USACE gets the opportunity to obtain Congressional guidance we will develop a plan to satisfy both GAAP and the regulatory accounting requirements for Hydropower. USACE will ensure the Financial

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Statements are appropriately adjusted to not include the accrued interest.

4. The POC for this response is Bill Holtzman (202) 761-1938.

FOR THE COMMANDER:

DONALD. J. RIPP
Chief, Audit Executive
U.S. Army Corps of Engineers

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Team Members

The Office of the Deputy Inspector General for Auditing of the Department of Defense, Defense Financial Auditing Service prepared this report. Personnel of the Office of the Inspector General of the Department of Defense who contributed to the report are listed below.

Paul J. Granetto
James L. Kornides
Amy J. Frontz
Anthony C. Hans
Kevin C. Currier
James C. Darrough
Brian L. Henry
Brian M. Stumpo
Bethany L. Seiple
Lusk F. Penn
James Hartman
Dharam V. Jain
Catherine Bird